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To: Honorable Mayor & Members of San Diego City Council

From: Andrew Poat

Re: FY 2006 State Budget Assessment

Date: January 12, 2005

Governor Schwarzenegger announced his proposed FY 2005-2006 State budget Monday, January 10. This proposal will be the subject of numerous budget hearings, and proposed amendment, in coming months. This memo provides the first of several reports analyzing the impact of these evolving budget proposals on the City of San Diego.

Executive Summary

- Budget proposal implements \$22.3 million reduction in City of San Diego local property tax revenues** as agreed to by the California League of Cities in a two year budget agreement adopted with the Governor last summer

Reductions affecting the General Fund \$17.3 million

- Property Tax Confiscation \$17.3 million

Reductions affecting Redevelopment Agencies \$ 4.9 million

- Centre City Development Corporation \$3.7 million
- Southeast Economic Development corporation \$903,000
- City Redevelopment Agency \$275,000

- Proposes \$5.4 million** in program reductions affecting City of San Diego programs in addition to those contained in last year's budget agreement

Reductions affecting the General Fund \$5.22 million

- Booking Fees: \$5.22 million

Reductions affecting Non-General Fund Operations \$203,000

- Public Library Fund \$80,970 (Est.)
- Arts & Culture \$122,032 (Est)*

(* Funding was last provided in FY 2003)

3. Proposes loaning \$1.3 billion in state transportation funds - \$403.25 million earmarked for the San Diego region - to the State General fund with repayment over 15 years

- Proposition 42 gas tax funds \$399,942,000
(Benefits highway, transit & local street/road projects throughout San Diego County)
- Local Streets & Roads \$3.25 million
(benefits City of San Diego)

4. Proposes pension policy changes affecting the City: The Governor announced his intention to constitutionally mandate that all California public agencies use defined contribution systems, rather than defined benefit programs, for employees hired after a proposed statewide initiative, if adopted by voters.

5. Proposes other state budget changes affecting the City: 15 year financing is proposed for repayment of several “loans” of local government and education funding, including transportation and State Mandate payments to regional and local governments.

Analysis

The City of San Diego derives over \$404 million of its annual \$739.8 million General Fund from revenues allocated by the State of California:

Source	Amount (FY04)	% of GF	State Discretion
Property Tax	\$199.8 million	27.0%	Allocation Formula
Sales Tax	\$124.8* million	16.9%	Allocation Formula
Motor Vehicle Fees	\$ 80.8 million	10.9%	VLF fee setting/Backfill
Booking Fees	\$ 5.22 million	0.7%	Program Funding
Total	\$410.62 million	55 %	

The City and region also receive significant additional state allocated revenues for transportation and grant programs. Proposals include:

Property Taxes:

Summary:

- For the second consecutive year, the City’s General Fund will receive \$17.5 million less in local property taxes. These funds are not a loan – and will not be recovered
- For the second consecutive year, the City’s three redevelopment agencies will forfeit \$4.878 million in property taxes, as follows:
 - CCDC \$3.7 million
 - SEDC \$903,000
 - City Agency \$275,000

The budget proposal reduces the share of local property taxes that will remain in San Diego County to provide for local governments. The City of San Diego’s property tax revenue estimate for fiscal year 2006 will not be available until March (budget proposal). Last year’s revenues were \$199.8 million. Independent of the revenue forecast, the City’s share of local

property taxes will be REDUCED \$17.5 million – and Redevelopment agencies of the City of San Diego will see reductions of \$4.9 million. These allocations are the City of San Diego’s “share” of \$1.3 billion in spending cuts requested by Governor Schwarzenegger of local governments last year – and negotiated with the California League of Cities. The agreement stipulates that local property taxes would be withheld from local governments in Fiscal Years 2005 and 2006, provided the Governor and Legislature establish constitutional protection of local revenues (Proposition 1A on the November 2004 ballot) in the future. Proposition 1A, adopted by voters last November, limits the occurrence and size of such confiscations in the future, and perhaps most important, requires repayment of the confiscated revenues within 3 years.

Vehicle License Fee

Summary: The budget proposes:

- Collecting fees at the existing .66% (2/3 of 1%) rate – and distribution of these revenues to local government – as required by the State Constitution
- Full payment of Vehicle License Backfill revenues. City of San Diego received \$80.8 million last year from vehicle license revenues.

A summary of this program appears in the appendix

Booking Fees

Summary: \$5.22 million booking fee reimbursement is not funded

A summary of this program appears in the appendix

Grant Programs

Summary: \$67, 470 decline in grant programs proposed

State grant programs provide funds earmarked for specific activities, ranging from public safety to libraries. The following chart reviews funding levels for the largest programs – and revenues received over the past three years. These revenues are generally not relied upon for operating budgets - but instead are used to augment services or make equipment acquisitions. These programs were provided no Proposition 1A protection.

See Chart – next page

Program	Beneficiary	FY2005	FY 2006 (Proposed)	Change
COPS	Police Department	\$1.9 million	\$1.9 million	None
Public Library Fund	Library Department	\$514,150	\$433,180	- \$80,970
Law Enforcement Technology Grants	Police Department	Eliminated	Eliminated	Up to \$364,000 received in the past
Arts & Culture	Arts & Culture Commission & City Arts organizations	\$0	\$0	Up to \$159,927 received in the past
California Teleconnect Fund	Libraries	\$110,000	\$123,500 (est)	+ \$13,500
Total		\$2,524,150	\$2,456,680	- \$67,470

Transportation Programs

Summary: The San Diego region, and the City of San Diego, benefit from allocations of Federal and state transportation revenues:

- 18 cent Federal gas tax – allocated by formula to the states and regions
- 18 cent state gas tax – allocated by formula to the regions of the state
- State sales tax on gasoline – allocated by both previous legislation and formula to regions and programs of the state

The Governor's budget proposal would redirect roughly \$1.3 billion generated by the state sales tax on gasoline – some \$403.25 million of which was earmarked for San Diego – to non-transportation programs.

- Local streets & roads Program: \$3.25 million earmarked for the City are instead directed to the State General Fund – with a long term loan repayment.
- Transportation Congestion Relief Program (TCRP)/Prop 42: \$400 million allocated to the San Diego region is similarly proposed for redirection to the State General Fund – with a long term loan repayment

Appendix 1 provides a summary of city programs that benefit from state funding.

Governor's Proposed Budget Reform

Arguing that state spending is growing faster than tax receipts, and that past spending excesses continue to require remedial initiatives, Governor Schwarzenegger proposed a series of changes to state law affecting the budget:

(1) Expanded authority for Governor to reconcile spending/revenue imbalances: Governor proposes to expand Executive authority to realign state spending with actual revenues when budgeted levels are found to be imbalanced. Some similar authority was established by voters in March, 2004 (Proposition 58)

(2) Debt Consolidation: The Governor broadly proposes to apply a formula to all special and dedicated funding categories within the state budget: confiscating such funds for an additional one to two years – with repayment of these funds for a period not to exceed 15 years:

- Transportation Spending - Proposition 42: Voters mandated in 2002 that sales tax generated on gasoline be deposited into the Transportation Investment Fund (TIF) – to be used only for transportation projects. Since its enactment, however, the Governor and Legislature have suspended its provisions each year to transfer these revenues to the State General Fund. The Governor now proposes to suspend Proposition 42 for two more years (2005-06 and 2006-07), then eliminate the ability to do so ever again. He further proposes that all confiscated Proposition 42 revenues (approximately \$5 billion total) be treated as loans to the General Fund to be repaid over 15 years
- Education Spending - Proposition 98: Amends formula by which minimum state spending on education is calculated, and the timeframe within which past “underpayments” and local mandate costs will be addressed
- Local Government Unfunded Mandates: Proposes payment over 15 year period.

(3) Pension Reform: Citing \$508 million annual increase in state pension costs, the governor proposes two changes:

- \$206 million in FY 2006 General Fund savings by renegotiating the employee share of benefits expansion costs adopted in Chapter 555, Statutes of 1999 (SB 400)
- Constitutional amendment that prohibits the State or any of its political subdivisions from offering defined benefit plans to new employees – moving instead to defined contribution plans.

Appendix 1: Analysis of State Programs affecting the City of San Diego

Property Tax Reallocation: The Governor is proposing to reduce by \$1.3 billion the amount of property taxes that are returned to local governments throughout the state, in favor of directing these funds to the State (as agreed to during the last budget year in exchange for the placement of Proposition 1A on the statewide ballot). Cities, Counties, Redevelopment Agencies and Special Districts would share the loss as follows:

	<u>Statewide</u>	<u>San Diego Impact</u>
Cities	\$350 million	\$17.3 million
Counties	\$350 million	N/A
Redevelopment Agencies	\$250 million	\$4.878 million
CCDC		\$3.7 million (Est)
City Redevelopment		\$903,000 (Est)
SEDC		\$275,000 (Est)
Special Districts	\$350 million	N/A

Impact to the City: The City's increased property tax confiscation would reduce the City's General Fund revenues by \$17.3 million. 54% of the City's General fund is spent on public safety.

Vehicle License Fees & Backfill: VLF fee of .65% and full funding of the VLF backfill account via property tax revenues is guaranteed by Proposition 1A:

	<u>Statewide Funding</u>	<u>San Diego Benefit</u>
2002 Final	\$3.4 billion	\$70.3 million
2003 as adopted	\$3.7 billion	\$72.2 million
2003 Final	\$2.4 billion	\$72.5 million
2004 Final	\$2.4 billion	\$74.9 million
2005 Proposed	\$3.8 billion	\$78.0 million
2005 Final	\$3.9 billion	\$80.8 million
2006 Proposed	\$4.9 billion	TBD

Impact to the City: The City expects to receive monthly VLF payments and semi-annual backfill payments.

COPS Funding:

	<u>Statewide funding</u>	<u>San Diego Benefit</u>
2002 Final	\$116,300,000	\$2.6 million
2003 as adopted	\$116,300,000	\$2.6 million
2003 Final	\$116,300,000	\$2.6 million
2004 Final	\$100,000,000	\$1.9 million
2005 Proposed	\$100,000,000	\$1.9 million
2005 Final	\$100,000,000	\$1.9 million
2006 Proposed	\$100,000,000	\$1.9 million (Est.)

Impact to the City: Funding will continue at current levels.

Booking Fees Reimbursement:

	<u>Statewide funding</u>	<u>San Diego Benefit</u>
2002 Final	\$38 million	\$5.22 million
2003 Final	\$38 million	\$5.22 million
2004 Final	\$38 million	\$5.22 million
2005 Final	\$38 million	\$5.22 million
2006 Proposed	\$0 – Eliminated	(\$0)

Impact to the City: Reduction of \$5.22 million to the City's General Fund.

Library Foundation:

	<u>State</u>	<u>San Diego Benefit</u>
2002 Final	\$52.97 million	\$1.7 million
2003 as adopted	\$41.8 million	\$1.6 million
2003 Final	\$26 million	\$1.03 million
2004 Final	\$15.7 million	\$565,000
2005 Proposed	\$15.8 million	\$565,000
2005 Final	\$14.36 million	\$514,150
2006 Proposed	\$12.1 million	\$433,180 (Est.)

Impact to the City: This state grant funds 21 library staff positions, plus all non-personnel expenses for the fund raising office. A fund balance resulting from previous year savings covers the FY '04 reduction - but will not be sufficient to offset service reduction beginning in '05.

California Teleconnect Fund:

	<u>State</u>	<u>San Diego Benefit</u>
2005 Final	\$17,974,000	\$110,000
2006 Proposed	\$20,253,000	\$123,500 (Est.)

Impact to the City: This program allows public schools, libraries, government owned health clinics and community based organizations to apply for a 50 percent discount on phone and computer network services, including Centrex, PBX trunks, and other phone lines plus Integrated Services Digital Network (ISDN), DSL and T-1 services which provide access to the Internet.

Technology Grants for Local Law Enforcement:

	<u>State</u>	<u>San Diego Benefit</u>
2002 Final	\$70.8 million	\$774,000
2003 as adopted	\$35.4 million	\$364,000
2003 Final	\$35.4 million	\$364,000
2004 Final	\$0	\$0
2005 Proposed	\$0	\$0
2005 Final	\$0	\$0
2006 Proposed	\$0	\$0

Impact to the City: The Governor's Budget does not provide funding for this program - designed to help local law enforcement agencies purchase high-technology equipment. This program has been eliminated since FY 2003.

Arts and Culture: California Arts Council (CAC) funding was all but eliminated in the FY 2004 – 2005 proposed budget. The minimal amount of funding was to administer the program, but did not make grant funds available to local governments or organizations.

	<u>Statewide funding</u>	<u>Arts Community</u>	<u>Arts & Culture Commission</u>
2002 Final	\$31 million	\$612,409	\$159,927
2003 as adopted	\$16 million	\$368,200	\$128,455
2003 as amended	\$15 million	\$TBD	\$122,032
2004 Final	\$1 million	\$0	\$0

2005 Proposed	\$1 million	\$0	\$0
2005 Final	\$1 million	\$0	\$0
2006 Proposed	\$1,171,000	\$0	\$0

Impact to the City: CAC Grants support the City’s Arts & Culture Commission, as well as the regional arts community. One of the principal programs funded is a partnership with the San Diego City Schools Visual and Performing Arts Department.

Appendix 2: Summary of State confiscation of local revenues

San Diego

Since 1992, the State has been confiscating local property taxes at a rate that now totals \$340 million over 12 years. The annual confiscation was \$64.4 million this year – and a similar level is proposed next fiscal year. These revenues are all taken from the General Fund, 54% of which is spent on public safety.

\$64.4 million is:

- larger than the entire trash collection budget (\$35 million)
- larger than the entire library budget (\$38 million)
- 88% of last year’s entire Park and Recreation budget (\$73 million)
- 52% of last year’s entire Fire department budget (\$124 million)
- 24% of last year’s entire Police department budget (\$270 million)

Statewide

- \$44 billion has been redirected through ERAF since its inception.
 - \$33.44 billion County Reduction (76%)
 - \$10.56 billion City Reduction (16%)
- Proposition 172 “mitigation”
 - \$2.35 billion to Counties (94%)
 - \$350 million to Cities (6%)

- Net – ERAF/Prop 172 Funds

	<u>ERAF Loss</u>	<u>Prop 172 Repayment</u>	<u>Net</u>
Cities	\$832 million	\$350 million	-\$482 million
Counties	\$3.95 billion	\$2.35 billion	-\$1.60 billion

Appendix 3: Redevelopment Agencies

Redevelopment Agency Contribution to the State: Redevelopment Agencies statewide would be responsible for contributing \$250 million of the \$1.3 billion local government contribution to balancing the state budget. Three agencies, the Centre City Development Corporation (CCDC), the City of San Diego Redevelopment Agency, and the Southeast San Diego Development Corporation (SEDC) would be forced to reschedule projects to accommodate funding reductions of:

<i>Impact to the City</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>
CCDC	\$1,250,000	\$1,250,000	\$3.7 million	\$3.7 million
City Agency	\$370,000	\$ 370,000	\$903,000	\$903,000
SEDC	\$117,000	\$ 117,000	\$275,000	\$275,000

Appendix 4: Transportation

The Governor's budget proposes:

- Suspension of Proposition 42

Proposition 42, enacted by the voters in 2002, requires the State to deposit the proceeds of the sales tax collected on the sale of gasoline into the Transportation Investment Fund (TIF). The TIF can only be used to pay for transportation projects. However, since its enactment, Proposition 42 has been suspended once and partially suspended a second time. Last year, the Governor reached an agreement with local governments to allow the State to take local property tax funds for two years, and then constitutionally prohibit such taking in the future. The Governor's Proposition 42 reform proposal takes a similar approach to sales tax on gasoline. It would allow the State to suspend Proposition 42 for two more years (2005-06 and 2006-07), but removes from the Constitution the ability to suspend after that. All Proposition 42 transfers that are suspended (approximately \$5 billion total) will be treated as loans to the General Fund.

Regional Transportation Projects

The following projects are expected to be at risk of reduction in funding under the proposed budget:

1. Projects Under Construction or in Operation

STIP and TCRP Projects	TCRP Allocated/Unexpended Funds at Risk	TCRP Allocation Needs in FY 2005/06	STIP Funds at Risk	Total At Risk
Sprinter	\$0	\$80,000,000	\$0	\$80,000,000
I-5/I-805 merge	\$14,563,000	\$0	\$0	\$14,563,000
I-15 Managed Lanes (Freeway Elements)	\$3,254,000	\$6,900,000	\$0	\$10,154,000
East Village Improvements	\$9,909,000	\$0	\$0	\$9,909,000
MTDB Bus Acquisition	\$7,766,000	\$0	\$0	\$7,766,000
Rideshare	\$0	\$0	\$1,790,000	\$1,790,000
Oceanside Transit Center	\$0	\$590,000	\$0	\$590,000
Planning and Program				

Monitoring	\$0	\$0	\$334,000	\$334,000
Sub – Total #1	\$35,492,000	\$87,490,000	\$2,124,000	\$125,106,000

2. Projects ready to proceed through FY 2005/06

STIP and TCRP Projects	TCRP Allocated/Unexpended Funds at Risk	TCRP Allocation Needs in FY 2005/06	STIP Funds at Risk	Total At Risk
SR 905 Freeway and Interchanges	\$9,904,000	\$0	\$102,756,000	\$112,660,000
SR 52 (SR 125 to SR 67)	\$162,000	\$20,000,000	\$0	\$20,162,000
Mid-Coast LRT	\$0	\$10,000,000	\$4,000,000	\$14,000,000
I-15 Managed Lanes – Transit Element	\$0	\$13,650,000	\$0	\$13,650,000
NCTD Bus Acquisition	\$456,000	\$7,700,000	\$0	\$8,156,000
I-5/Lomas Santa Fe Interchange	\$0	\$6,000,000	\$0	\$6,000,000
SR 56 Landscaping	\$0	\$3,430,000	\$0	\$3,430,000
Encinitas Grade Separation	\$0	\$1,448,000	\$0	\$1,448,000
Freeway Operational Improvement	\$0	\$0	\$1,060,000	\$1,060,000
Federal Matching Funds	\$0	\$0	\$440,000	\$440,000
Caltrans Operations & Rehabilitation Projects	\$0	\$0	\$0	\$83,400,000
Sub – Total #2	\$10,522,000	\$62,228,000	\$108,256,000	\$264,406,000

3. Projects ready to proceed after FY 2005/06

STIP and TCRP Projects	TCRP Allocated/Unexpended Funds at Risk	TCRP Allocation Needs in FY 2005/06	STIP Funds at Risk	Total At Risk
SR 94 Widening	\$2,873,000	\$0	\$0	\$2,873,000
I-5/Virginia Avenue Realignment	\$421,000	\$2,000,000	\$0	\$2,421,000
SR 94/SR 125 Connectors	\$648,000	\$0	\$0	\$648,000

Double Track Modifications	\$72,000	\$0	\$0	\$72,000
Sub – Total #3	\$4,014,000	\$2,000,000	\$0	\$6,014,000

4. Projects completed or nearly completed

STIP and TCRP Projects	TCRP Allocated/Unexpended Funds at Risk	TCRP Allocation Needs in FY 2005/06	STIP Funds at Risk	Total At Risk
SR 56 (Middle)	\$3,788,000	\$0	\$0	\$3,788,000
SR 94/SR 125 Interim Connectors	\$499,000	\$0	\$0	\$499,000
Coaster Commuter Rail Train Set	\$129,000	\$0	\$0	\$129,000
Sub – Total #4	\$4,416,000	\$0	\$0	\$4,416,000
Total Potential Losses	\$54,444,000	\$151,718,000	\$110,380,000	\$399,942,000

Local Streets & Roads (AB 2928): This program was institutionalized by voter approval of Proposition 42. The City and region of San Diego receives a percentage of revenues. Confiscation of these fund and repayment over 15 years is proposed

	Prop 42 Revenues	San Diego Share (if paid)	San Diego Received
2002 Final	TBD	\$2.4 million	\$2.4 million
2003 as adopted	TBD	\$4.4 million	\$4.4 million
2003 as amended	TBD	\$3.25 million	\$3.25 million
2004 Final	TBD	\$3.25 million (est)	\$0
2005 Proposed	\$179.5 million	\$3.25 million (est)	\$0
2005 Final	\$179.5 million	\$3.25 million (est)	
2006 Proposed	\$0 – Reverted to State General Fund		

Appendix 5: Property Tax and Proposition 1A

Proposition 13, adopted by voters in 1978, transferred authority for the allocation of local property taxes away from local government to the State Legislature. Since 1992, the State has utilized this authority to confiscate over \$340 million in local taxes from the City of San Diego alone – some \$44 billion statewide.

The current budget year agreement contains several additional reductions in local government funding. These reductions were part of an agreement reached between local governments, the Governor and the Legislature in exchange for placing Proposition 1A on the November 2004 ballot. Those reductions include:

- \$17.3 million reduction in General Fund revenues. This amounts to San Diego's "share" of the \$1.3 billion contribution local governments will make to addressing the state budget deficit
- \$4.9 million reduction in funds available to Redevelopment Agencies of the City of San Diego, allocated as follows
 - CCDC \$3.7 million
 - SEDC \$903,000
 - City Agency \$275,000
- \$1.5 million reduction in grant programs that benefit the City of San Diego. These funds are NOT part of the City's General Fund
 - COPS Funding \$400,000 (est.)
 - Public Library Fund \$565,000 (est.)
 - Law Enforcement Technology Grants \$364,000 (est.)
 - Art & Culture \$122,000 (est)

Proposition 1A, adopted by voters in November 2004 as a means to protect local government from continued reductions in property tax, protects each local government's individual property tax shares (including growth) plus those additional property tax revenues under the triple flip, and VLF swap.

Beginning in 2008-09, after issuance of a proclamation of fiscal emergency by the governor and approval by the legislature of a separate urgency bill by a 2/3 vote, the state may borrow local property taxes (apportioned initially among cities, counties, special districts and redevelopment agencies as in 2004-05 and 2005-06). The terms under which suspension would only be allowed are:

- Prerequisites:
 - Repayment of the VLF Gap Loan as required in 2006-07.
 - Repayment of outstanding deferred mandate reimbursements.
 - No previous outstanding loan from local governments.
- Sums must be repaid with interest (PMIB rate) within three years.
- No more than 8% of local governments' share (\$1.3 billion in FY 04 – 05 dollars) may be borrowed at any time.
- No more than two loans may occur during any ten-year period.
- Repayment is constitutionally guaranteed and the bill approving the suspension shall identify the appropriate source of revenue that is pledged, to and appropriated for, timely repayment to allow local governments to borrow against the state's repayment obligation.

Sales Tax: For each jurisdiction, protect the existing Bradley-Burns 1% sales tax rate and method of distribution, plus local sales tax add-ons (e.g., transportation, library, etc.). Guarantee return of ¼ cent sales tax to cities and counties when Prop 57 bonds retired.

Appendix 6: Booking Fees

Historically, counties provided detention facilities for incarceration of suspects apprehended by several levels of local law enforcement. Until 1990, the costs of operating these facilities was generally handled by County governments. After that date, state law was amended to permit counties to charge booking fees, not to exceed actual administrative costs, for processing persons arrested by a non-county entity. San Diego is one county that has elected to charge this fee.

The Legislature, in an effort to provide financial relief to cities that are charged the fees, originally heard proposals to abolish the County's booking fee authority. Instead, by enacting AB 1662 in July 1999, the Legislature elected to establish the reimbursement program as they believed the booking fees were a deterrent to frivolous bookings. This program reimburses 373 cities each year and costs the State approximately \$38 million annually.

The City of San Diego entered into a contractual agreement with the County of San Diego rather than a traditional booking fee paid by other cities. The contract, finalized in a January, 1999 MOU, requires the City to pay \$5.22 million annually to the County in consideration for a guaranteed number of beds for prisoners. The County used this reliable source of revenue to bond finance construction of a downtown jail.

Legislation was passed (SB 225 – 1999) to clarify that the City/County relationship in San Diego qualified for state reimbursement. Each June the City submits a \$5.22 million payment to the County for the entire year's booking fees.

The Booking Fee program was proposed elimination in last year's budget. A compromise provided the following:

- Full funding in FY 2004
- Repeal of the booking fee statute AFTER FY 2004